No. 73-799

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In the Supreme Court of the United States

OCTOBER TERM, 1973

BAY SOUND TRANSPORTATION CO., ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ROBERT H. BORK,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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Petitioners are corporations owned or controlled by C.W. Edwards and his son Keith Edwards. The corporations own tugs and/or barges. The sole question presented is whether petitioners are entitled to the corporate surtax exemption provided by Section 11 of the Internal Revenue Code of 1954 for the years 1958-1960.

1. During the years at issue, Section 11 allowed each corporation an exemption for its first $25,000 of taxable income from the 22 percent surtax. The first $25,000 of taxable income was subject only to the normal tax of 30 percent and the excess was subject to a 52 percent tax rate. As a result, the overall tax liability of a business would be much less if its income were divided among several corporations.

In order to discourage the tax-motivated use of multiple corporations by what is essentially a single business,

Section 1551 of the Code denies the surtax exemption to a corporation which receives property from another corporation where: (1) the transferee corporation was created for the purpose of receiving the property or was not actively engaged in business at the time of the transfer; and (2) if the transferor and transferee are under common control. The provision applies unless the transferee establishes by a "clear preponderance of the evidence" that the securing of the surtax exemption was not a major purpose of the transfer.

The disallowance of petitioners' surtax exemptions for the years 1958-1960 by the Commissioner under Section 1551 was upheld by the district court in the first stage of this litigation (Pet. Add. 12-64). The court of appeals reversed, holding that Section 1551 was inapplicable because the evidence did not establish that any corporation transferred the boats. The court remanded the case, however, for the district court "to determine whether or not the findings of fact on the record are sufficient to disallow the exemptions of the surtax under Section 269," which had also been urged by the Commissioner (Pet. Add. 1-8).[1] Section 269(a) of the Code provides that if any person acquires a controlling stock interest in a corporation "and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed."

On remand, the district court adopted the findings of fact contained in its original memorandum and found in

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[1]The opinion of the court of appeals is officially reported at 410 F. 2d 505. This Court denied a petition for a writ of certiorari filed by petitioners from that decision. 396 U.S. 928.

addition that petitioners had failed to establish that "the principal purpose motivating the separate incorporation of the various barges and vessels acquired by the Edwards fleet in 1955 and the years subsequent thereto was not the evasion or avoidance of federal income taxes by securing multiple surtax exemptions." It further found that the "preponderance of the evidence of record established that the principal purpose motivating the separate incorporation * * * was the evasion or avoidance of federal income taxes by the securing of multiple surtax exemptions" (Pet. Add. 83).[2] The court of appeals affirmed *per curiam* (Pet. Add. 91).

2. Petitioners contend (Pet. 12) that "it is an unconstitutional taking of property without due process, in violation of the Fifth Amendment, for the government intentionally and irrationally to exact a federal tax in an unequal manner." The sole basis for this argument is the fact that the government did not appeal the decision of the district court in *Tidewater Hulls, Inc.* v. *United States,* 68-1 U.S.T.C., par. 9405 (E.D. La., 1968). There, the district court found that various tug and barge-owning corporations separately incorporated by the Laborde interests had not been separately incorporated principally for the prohibited purpose. But the government's failure to appeal that decision cannot support petitioner's Fifth Amendment claim of discriminatory treatment.

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[2]The evidence showed that Charles Edwards, the major stockholder, made the ultimate determination concerning utilization of multiple corporations (Pet. Add. 48, 74). Although he claimed that taxes played no part in his decision to incorporate separately, and that he had not discussed such matters with his tax advisors, there was substantial evidence supporting the finding that the separate incorporations were tax-motivated (Pet. Add. 46-48, 76-77). His assertion that limitation of liability was the principal purpose for separate incorporation was contradicted by the fact that he allowed much of his business to remain in partnership form (Pet. Add. 81-82).

The ultimate question in every Section 269 case is the factual one whether the taxpayer's principal purpose for an acquisition was for the evasion or avoidance of tax. The government's refusal in one case to challenge a district court's determination on particular facts as "clearly erroneous" can have no bearing on the validity of the determination by another district court in another case involving entirely different taxpayers, regardless of the alleged factual similarities between the two cases. Indeed, the fact that the government contested the separate surtax exemptions in both the *Tidewater* and this case is sufficient to refute any allegation of discriminatory treatment against petitioners.

3. Contrary to petitioners' assertion (Pet. 16-22), there is no conflict of decisions. *Sirbo Holdings, Inc.* v. *Commissioner,* 476 F. 2d 981 (C.A. 2), is not in point. There the court reversed the Tax Court's finding that a tenant's payment to a landlord in satisfaction of the tenant's obligation to restore the premises was ordinary income to the landlord, rather than income taxable at capital gains rates, because the Commissioner in a contemporary Tax Court case (*Boston Fish Market Corp.* v. *Commissioner,* 57 T.C. 884) had conceded that such a receipt was not taxable at ordinary income rates. The only remaining question was whether such a payment was taxable at capital gains rates or was excludable from income. There is no such conflict between the legal position of the government here and in the *Tidewater* case.

Similarly, petitioner's reliance upon *Farmers' and Merchants' Bank* v. *United States,* 476 F. 2d 406 (C.A. 4), is misplaced. That decision rejected an attempt by the Commissioner (through a retroactive ruling) to apply different tax treatment to identically situated taxpayers on the basis of a different legal standard, without

showing a rational basis for the difference. Unlike that case, the questions here and in *Tidewater* are factual and, at all events, the government contested the surtax exemptions in both cases.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

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